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Is Local Government the Equivalent of State Government for Purposes of the Market Participant Exception to the Dormant Commerce Clause?

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Comments

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I. Introduction

The Commerce Clause of the United States Constitution grants Congress the power to regulate interstate commerce.[1] The Supreme Court has interpreted the Commerce Clause to have a negative or dormant aspect.[2] The Dormant Commerce Clause is a judicial doctrine standing for the proposition that the existence of the Constitution's federal commerce power restricts the states from burdening interstate commerce.[3]

The Dormant Commerce Clause restricts state activity even in the absence of congressional regulation in a given area.[4] State

1. *See* U.S. CONST. art. I, § 8, cl. 3 ("Congress shall have power . . . to regulate Commerce . . . among the several States.").

2. *See Oregon Waste Sys., Inc. v. Dep't. of Envtl. Quality*, 511 U.S. 93, 98 (1994); *see also New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273 (1988) ("It has long been accepted that the Commerce Clause not only grants Congress the authority to regulate commerce among the States, but also directly limits the power of the States to discriminate against interstate commerce.").

3. *See Oregon Waste Sys., Inc.*, 511 U.S. at 98.

4. *See Southern Pac. Co. v. Arizona*, 325 U.S. 761, 769 (1995).

regulations that discriminate against interstate commerce by favoring in-state interests over out of-state competitors "are routinely struck down, 'unless the discrimination [they impose] is demonstrably justified by a valid factor unrelated to economic protectionism.'"[5] However, if the state is acting as a market participant then the state action, even if imposing a burden on interstate commerce, is valid under the Dormant Commerce Clause.[6]

The subject of this comment is the application of the market participant exception to the Dormant Commerce Clause when state government is directing the proprietary activities of local government. Section II will provide a brief historical background of the Dormant Commerce Clause. Section III will discuss both the modern Supreme Court's Dormant Commerce Clause jurisprudence as well as the Court's purpose in creating the market participant exception. Section IV will discuss and analyze the differing market participant approaches applied by the Federal Courts of Appeals to situations where the state is directing the proprietary actions of local government.[7] This section will focus on the Seventh Circuit's decision in *W.C.M. Window Company, Incorporated v Bernardi,*[8] and how the Eighth Circuit, *in National Solid Waste Management Association v. Williams,*[9] declined to follow the reasoning of the *W.C.M. Window* court, instead adopting the approach favored by the Third, Fourth and Ninth Circuits.[10]

Section V will discuss which circuit's approach is best supported in light of Supreme Court precedent in areas involving

5. *Big Country Foods, Inc. v. Board of Educ.*, 952 F.2d 1173, 1177 (9th Cir. 1992).

6. *See Reeves, Inc. v Stake*, 447 U.S. 429, 437 (1990).

7. *Compare W.C.M. Window Co., Inc.,. v. Bernardi*, 730 F.2d 486, 494 (7th Cir. 1984) *with National Solid Waste Mgmt. Ass'n. v. Williams*, 146 F.3d 595,597 (8th Cir. 1998), *and Smith Setzer & Sons, Inc. v. South Carolina Procurement Review Panel*, 20 F.3d 1311, 1319-20 (4th Cir. 1994), *and Big Country Foods, Inc. v. Board of Educ.*, 952 F.2d 1173, 1179 (9th Cir. 1992), *and Trojan Tech., Inc. v. Pennsylvania*, 916 F.2d 903, 911 (3d Cir. 1990). The Seventh Circuit characterizes the state as a regulator when the state directs the purchasing of local government entities when the purchasing is done for a non-state funded or administered project. *See W.C.M. Window Co., Inc., 730 F.2d at 494.* The Third, Fourth, Eighth and Ninth Circuits favor an approach that views local government as a subpart of the state. *See National Solid Waste Mgmt. Ass'n.*, 146 F.3d at 597; *Smith Setzer & Sons, Inc.*, 20 F.3d at 1319-20; *Big Country Foods, Inc.*, 952 F.2d at 1179; *Trojan Tech., Inc.*, 916 F.2d at 911 Thus the state is not acting as a regulator, but as a purchaser when it directs the proprietary actions of local government. *See id.*

8. 730 F.2d 486 (7th Cir. 1984).

9. 146 F.3d 595 (8th Cir. 1998).

10. *See id.* at 599.

the relationship between state and local government, the Dormant Commerce Clause and the market participant exception.

II. A Negative Commerce Power?

The United States Supreme Court has historically used the Commerce Clause as a means to eliminate interstate trade disputes.[11] The Court has stated that one of the great improvements of the U.S. Constitution was eliminating these disputes "[which] had plagued the relations among the colonies and later among the states under the Articles of Confederation."[12]

The Supreme Court first discussed the existence of the dormant aspect of the Commerce Clause in *Gibbons v. Ogden,*[13] in which the court stated that the Commerce Clause can limit the states' ability to regulate in a given area even in the absence of a preemptive exercise of the federal commerce power.[14]

The Dormant Commerce Clause has been traditionally used by the United States Supreme Court to respond to state taxes and regulatory measures that impede interstate commerce.[15] "This nation is a common market in which state laws cannot be made barriers to the free flow of both raw materials and finished goods in

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11. *See Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979).

12. *Id.*; *see also Hughes v. Alexandria Scrap* Corp., 426 U.S. 794, 807 (1976) (*Alexandria Scrap* states: "The [Commerce] Clause was designed in part to prevent trade barriers that had undermined efforts of the fledging states to form a cohesive whole following their victory in the revolution.").

13. *See Gibbons v. Ogden*, 22 U.S. 1 (1824).

14. *Gibbons*, 22 U.S. at 17-18. Chief Justice Marshall's opinion in *Gibbons* describes the relationship between the states and the federal government in the absence of congressional action in an area effecting interstate commerce:

> This doctrine of a *general* concurrent power in the States, is insidious and dangerous. If it be admitted, no one can say where it will stop. The States may legislate, it is said, wherever Congress has not made a *plenary* exercise of its power. But who is to judge whether Congress has made this *plenary* exercise of power? Congress has acted on this power; it has done all that it deemed wise; and are the States now to do whatever Congress has left undone? Congress makes such rules as, in its judgment, the case requires; and those rules whatever they are constitute the *system*. All useful regulation does not consist in restraint; and that which Congress sees fit to leave free, is a part of its regulation, as much as the rest.

See id. at 17-18. *See also Cooley v. Board of Wardens of the Port of Philadelphia*, 53 U.S. 299, 305 (1851) (stating with regards to the recognition of a negative commerce power in *Gibbons*: "The decision in *Gibbons v. Ogden* has never been in the least degree questioned or shaken. . .Any other rule would be fatal to the peace of the country.").

15. *See Reeves, Inc.*, 447 U.S. at 437.

response to the economic laws of supply and demand."[16] Those Supreme Court decisions in which the Dormant Commerce Clause is used to declare a state law unconstitutional usually deal with state activity that interferes with the national market through regulations or prohibitions.[17]

III. The United States Supreme Court's Modern Dormant Commerce Clause Approach.

The modern Supreme Court's Dormant Commerce Clause approach was illustrated in *Pike v. Bruce Church, Incorporated.*[18] *Pike* dealt with an Arizona packaging requirement imposed on intrastate fruit growers.[19]

The court laid out a three-part analysis to determine whether a state regulation is constitutional under the Dormant Commerce Clause.[20] First, the statute or regulation must meet a legitimate state interest.[21] Second, the regulation must be related to the legitimate interest.[22] Third, the regulatory burden imposed by the state on interstate commerce must be outweighed by the legitimate state interest.[23]

Whether a state regulation violates the Dormant Commerce Clause also depends on whether the state is acting as a regulator or as a market participant.[24] The first United States Supreme Court case to articulate the market participant exception was *Hughes v.*

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16. *Alexandria Scrap Corp.*, 426 U.S. at 803.

17. *See id.* at 806 ("The common thread of all these cases is that the state interfered with the natural functioning of the interstate market either through prohibitions or through burdensome regulations.").

18. 397 U.S. 137 (1970).

19. *See id.* at 138.

20. *See id.* The court described the necessary analysis of state regulation under the Dormant Commerce Clause as follows:

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course be dependant on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities. (citations omitted)

See id.

21. *See id.*

22. *See Pike*, 397 U.S. at 138.

23. *See id.*

24. *See Reeves, Inc.* 447 U.S. at 436-37.

Alexandria Scrap Corporation.[25] In *Alexandria Scrap* the court held that if the state is acting as a market participant, then state activity that burdens interstate commerce is not in violation of the Dormant Commerce Clause.[26] "Nothing in the purpose animating the Commerce Clause prohibits a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others."[27]

The application of the market participant exception does not mean that the challenged state activity presents no burden on interstate commerce.[28] Rather, the exception applies when the state is acting as a participant in the market rather than as a regulator and therefore any effect on interstate commerce represents a *permissible* burden by the challenged state activity.[29] Thus, if the threshold inquiry as to whether the state is a regulator or a market participant leads to the conclusion that the state is merely entering the market, no independent justification for such market action by the state is required under Dormant Commerce Clause Analysis.[30]

The state's character when it enters the market serves as justification for the market participant exception.[31] When a state buys or sells, the state has characteristics of both "a political entity and a private person," and like a private person the state in this guise has unlimited power to determine with whom it will deal.[32]

The Court has further justified the market participant exception due to concerns for state sovereignty and the state's role as trustee for its citizens.[33] Thus, the market participant exception

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25. *See Alexandria Scrap Corp.*, 426 U.S. at 808. The court introduced the market participant exception by stating:

> Until today the court has not been asked to hold that the entry of the state itself into the market as a purchaser, in effect, of a potential article of interstate commerce creates a burden upon that commerce if the state restricts its trade to its own citizens or businesses within the state...We do not believe the Commerce Clause was intended to require independent justification for such action.

See id.

26. *See id.* at 810.

27. *Id.*; see *also Independent Charities of Am., Inc. v. Minnesota*, 82 F.3d 791, 795 (8th Cir. 1996) (The Eighth Circuit, in *Independent Charities of Am., Inc.*, explained the reason for the market participant exception: "[T]here is no indication that the [Commerce] Clause was intended to limit the ability of the states themselves to operate in the free market.").

28. *See Reeves, Inc.*, 447 U.S. at 436.

29. *See id.* at 435.

30. *See id.* at 436; *W.C.M. Window Co., Inc.*, 730 F.2d at 494.

31. *Reeves, Inc.*, 447 U.S. at 439.

32. *See id.* at 437 (holding that state proprietary functions are exempt from Commerce Clause scrutiny).

33. *See id.* at 438 ("Restraint in this area is also counseled by considerations of

allows the state to engage in proprietary activities[34] for the benefit of its residents without concern for the restrictions created by the Dormant Commerce Clause.[35] Additionally, activities and considerations involving state proprietary action "will often be subtle, complex, politically charged and difficult to assess under traditional Commerce Clause analysis."[36] Therefore, another justification for the market participant exception is ease of application when courts analyze the burden imposed by state proprietary activity on the national market.[37]

IV. The Application of the Market Participant Exception to Cases Involving a State Directing the Proprietary Activities of Local Government

A. The State as Regulator or the State as Market Participant?

The purpose behind the Dormant Commerce Clause is to prevent "economic protectionism," meaning state regulatory action that discriminates in favor of in-state businesses over out-of-state competitors.[38] However, if a state is acting as a market participant, rather than as a market regulator, the Dormant Commerce Clause places no restriction on state activities.[39] "Put roughly, the market participant doctrine protects states when they are acting as parties to a commercial transaction rather than. . .when they are acting as market regulators."[40]

Whether the market participant exception applies when state government directs the proprietary activities of local government depends on the characterization of the state's actions toward the local government entity. If the state is viewed as regulating the activities of the local government entity, and the local government is viewed to be a participant in the market independent from the state, then the market participant exception should not apply. State

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state sovereignty, the role of each state as 'guardian and trustee for its people.'") (citing *Heim v. McCall*, 239 U.S. 178, 191 (1915)).

34. The Supreme Court has described those state actions which fall under the market participant exception to the Dormant Commerce Clause as "proprietary functions," meaning purchasing, selling, hiring or subsidizing activities. *See Reeves*, 437 U.S. at 437.

35. *See id.*

36. *Id.* at 439.

37. *See id.*

38. *See New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 274 (1988).

39. *See South-Central Timber Dev. v. Wunicke*, 467 U.S. 82, 93 (1984).

40. *Reeves, Inc.*, 447 U.S. at 437.

regulatory activity should then be analyzed under traditional Dormant Commerce Clause analysis, as described in *Pike*.[41] Viewing the state as a regulator when it directs the proprietary action of intrastate local government entities is the approach taken by the Seventh Circuit.[42]

However, if local government is seen by the courts as merely an extension of the state government, deriving its existence and authority from the state, then the state government's directing the proprietary actions of local government would merely be the state acting as a participant in the market through the local agencies which it has created and over which it has ultimate control. If state and local government are one in the same for purposes of the Dormant Commerce Clause, then the market participant exception should apply when the state directs the proprietary actions of local government. This is the approach taken by the Third, Fourth, Eighth and Ninth Circuits.[43] The Supreme Court has not chosen to resolve the issue.[44]

B. The Seventh Circuit's Approach: The State as Regulator

In *W.C.M. Window*, the Seventh Circuit stated that the market participant exception should not apply when a state is directing the proprietary activities of local government.[45] The court found that in such cases, the market participant is actually the local government entity, and the state is acting as a regulator.[46]

W.C.M. Window addressed the constitutionality of an Illinois statute giving preference to Illinois laborers.[47] The act stated that any contractor working on a public works project for the state must hire Illinois' laborers unless Illinois' laborers are either unavailable or incapable of performing the necessary type of work.[48]

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41. *See Pike*, 397 U.S. at 142.

42. *See W.C.M. Window Co., Inc.*, 730 F.2d at 495.

43. *See National Solid Waste Mgmt. Ass'n.*, 146 F.3d at 597; *Smith Setzer & Sons, Inc.*, 20 F.3d at 1319-20; *Big Country Foods, Inc.*, 952 F.2d at 1179; *Trojan Tech., Inc.*, 916 F.2d at 911.

44. *See National Solid Waste Mgmt Ass'n v. Williams*, 525 U.S. 1012 (1998) (writ of certiorari denied); *Trojan Tech., Inc. v. Pennsylvania*, 501 U.S. 1212 (1990) (writ of certiorari denied).

45. *See W.C.M. Window Co., Inc.*, 730 F.2d at 495.

46. *See id.*

47. *See id.* at 489.

48. *See id.* at 495. The court described the challenged statute as follows:

> The Act provides that the contractor on 'any public works project. . .for the state of Illinois or any political subdivision, municipal corporation or other governmental unit thereof shall employ only Illinois laborers on such project or improvement,' unless. . .Illinois laborers either 'are not

W.C.M. Window, an Illinois corporation, was hired to replace windows by an Illinois' school board.[49] W.C.M. Window subcontracted the work out to an association of Missouri residents.[50] Bernardi, the director of the Illinois Department of Labor, filed suit in state court seeking to enjoin W.C.M. Window from violating the preference law.[51] W.C.M. Window filed suit against Bernardi in the district court seeking a temporary restraining order to prevent Bernardi from proceeding with the state court action.[52]

The federal district court found that the preference law violated the Dormant Commerce Clause.[53] Bernardi appealed the district court's decision to the U.S. Court of Appeals for the Seventh Circuit.[54] The Court of Appeals found that the preference law was in effect a tariff, which unconstitutionally burdened interstate commerce.[55]

The court stated that if Illinois had limited the preference law to construction projects that were administered or financed to some degree by the state, then the law would not have violated the Dormant Commerce Clause.[56] The court reasoned that a limited preference law would have fallen under the market participant exception, as the state would have been acting as a participant, due to its administrative or financial role in the projects.[57]

However, the preference law applied to every public construction project in the state, regardless of the state's role in the project.[58] The court found that the window-replacement project at issue in the case was neither administered nor financed by the state, and that the market participant was the school board that wanted the windows replaced, not the state of Illinois.[59] The court stressed that for purposes of Dormant Commerce Clause analysis, every local government unit will not be considered as part of the state government, given that all state governments are decentralized and that local government agencies often have substantial autonomy.[60]

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available, or are incapable of performing the type of work involved.' *See id.*

49. *See W.C.M. Window Co.*, Inc., 730 F.2d at 489.
50. *See id.*
51. *See id.* at 490.
52. *See id.* at 489-90.
53. *See id at 495.*
54. *See W.C.M. Window Co.*, Inc., 730 F.2d at 495.
55. *See id.*
56. *See id.*
57. *See id.*
58. *See id.*
59. *See W.C.M. Window Co.*, 730 F.2d at 495.
60. *See id.*

The Seventh Circuit found that in passing the law the state of Illinois was in fact regulating the conduct of independent local entities.[61]

C. *The Approach Adopted By the Eighth Circuit: Following the Third, Fourth, and Ninth Circuits in Declaring the State and Local Government a Unified Market Participant*

Those Federal Courts of Appeals who have also decided cases in which the state directs the proprietary functions of local government have declined to follow the reasoning of the Seventh Circuit.[62] In *National Solid Waste Management Association,* the Eighth Circuit held that the market participant exception applies when the state is regulating the conduct of local government.[63] This is the most recent decision in a line of Federal Court of Appeals cases taking a similar position.[64]

The Eighth Circuit found that when the state is directing local government purchases, the local government is equivalent to the state for purposes of determining whether the state is acting as a market participant.[65] In *National Solid Waste Management Association*, the court upheld the constitutionality of Minnesota's Waste Management Act.[66] This act required counties to implement comprehensive waste management plans, and required public entities to manage their waste in accordance with their respective county's plan.[67]

The National Solid Waste Management Association ("Association") was a group of Minnesota waste disposal businesses. The Association filed suit against the state alleging that the act violated the Commerce Clause because the state was regulating the purchasing of local entities who were market participants independent from the state.[68] The district court granted

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61. *See id.* ("The state is a regulator, telling thousands of local government units that they must not give construction contracts to employers of nonresidents.").

62. *See National Solid Waste Mgmt. Ass'n.*, 146 F.3d at 597; *Smith Setzer & Sons, Inc.*, 20 F.3d at 1319; *Big Country Foods, Inc.*, 952 F.2d at 1179; *Trojan Tech., Inc.*, 916 F.2d at 911.

63. *See National Solid Waste Mgmt. Ass'n,* 146 F.3d at 599.

64. *See id* at 597. The Third, Fourth, and Ninth Circuits agree with this ruling. *See Smith Setzer & Sons, Inc.*, 20 F.3d at 1319; *Big Country Foods, Inc.*, 952 F.2d at 1179; *Trojan Tech., Inc.*, 916 F.2d at 911.

65. *See National Solid Waste Mgmt. Ass'n,* 146 F.3d at 597.

66. *See* MINN. STAT. §§ 115a.46, 473.803 (West 1997).

67. *See National Solid Waste Mgmt. Ass'n.*, 146 F.3d at 597.

68. *See id.* at 599.

summary judgement for the state. As a result, the Association appealed to the Court of Appeals for the Eighth Circuit.

The Eighth Circuit found that the state of Minnesota was acting as a market participant in directing the purchasing of local government.[69] The court reasoned that all local government entities are created by the state and their authority derives from the state.[70] The court found that local government entities, which are clearly subject to the power of the state, are not acting independent of the state when they contract for the removal of their waste.[71] The Eighth Circuit determined that in this situation the state is merely acting as a market participant and is therefore free to choose the parties with whom it does business with as if it were a private entity.[72]

The Third, Fourth and Ninth Circuits have in the past adopted an approach that is in agreement with that of the Eight Circuit's recent holding *in National Solid Waste Management Association.* The Ninth Circuit, in *Big Country Foods, Incorporated v. Board of Education,*[73] addressed the constitutionality of an Alaskan statute giving seven percent bidding preference to Alaskan milk producers who sold milk to Alaskan school districts.[74]

The Ninth Circuit found that the Alaskan preference statute was not in violation of the Dormant Commerce Clause because "[a] state should not be penalized for exercising its power through smaller, localized units; local control fosters both administrative efficiency and democratic governance."[75] The court found that political subdivisions exist at the will of the state, and therefore local government agencies should be considered as part of the state government for purposes of Dormant Commerce Clause analysis.[76]

The Ninth Circuit's approach, that courts should be reluctant to make case specific inquiries into whether local government units are acting independent from state, is a practical analysis.[77] This approach, unlike that of the *W.C.M. Window* court,[78] does not

69. *See id.* at 599.
70. *See id.*
71. *See id.* at 599-600.
72. *See National Solid Waste Mgmt. Ass'n*, 146 F.3d at 599.
73. *Big Country Foods, Inc. v. Board of Educ.*, 952 F.2d 1173 (9th Cir. 1992).
74. *See id.* at 1175.
75. *Id* at 1179.
76. *See id.* ("A rule that would consider all political subdivisions as separate from state control for market participant purposes would be anomalous to the proposition that political subdivisions exist at the will of the state.").
77. *See id.*
78. *See W.C.M. Window Co., Inc.*, 730 F.2d at 495.

require courts to make case-by-case inquiries into the degree of autonomy held by a local government entity and how that level of autonomy impacts the relationship with the state government when the state is directing the purchasing of the local government.[79]

In *Trojan Technologies, Incorporated v. Pennsylvania*[80], the Third Circuit also found that the market participant exception applied when state government directs the purchasing of local government.[81] The case dealt with a Pennsylvania statute requiring suppliers who contract with a state agency to use American made steel in their products.[82]

In analyzing the validity of the Pennsylvania preference law, the Third Circuit declined to follow the reasoning of the Seventh Circuit.[83] The court stated: "[w]e find no compelling analytical difference between a local government unit and central state agencies. Both exist only through affirmative acts of the state. A municipality derives its authority from the state."[84]

The Third Circuit found that under Pennsylvania law, local government entities are created by and subject to the control of the state.[85] The court reasoned that if a state can impose restrictions on the contracting authority of central state agencies and fall under the market participant exception, then the state should be able to impose those same restrictions on local agencies, whose authority, like central agencies, derives from the state.[86]

The Fourth Circuit has reached the same conclusion as the Third, Eighth and Ninth Circuits in *Smith Setzer & Sons, Incorporated v. South Carolina Procurement Review Panel,*[87] stating: "...[w]e do not believe that [*W.C.M. Window*] reflects the better view regarding the parameters of the market regulator/market participant distinction under the negative Commerce Clause."[88] The case dealt with a Dormant Commerce Clause challenge to a South Carolina statute which gave preferences in the bidding

79. *See Big Country Foods, Inc.*, 952 F.2d at 1179 (the court stated that considering some political subdivisions separate from the state "would lead to difficult case-specific inquiries into the degree of the subdivisions autonomy").

80. 916 F.2d 903 (3rd Cir. 1990).

81. *See id.* at 910.

82. *See id.* at 904

83. *See id.* at 911.

84. *Id.*

85. *See Trojan Tech., Inc.*, 916 F.2d at 904 ("Under Pennsylvania law it is clear that the local bodies covered by the statute exist only by the grace of state authority and with such powers as the state affirmatively provides.").

86. *See id* at 911.

87. 20 F.3d 1311 (4th Cir. 1994).

88. *Id.*

process for state projects to state vendors, as well as domestic vendors generally.[89] The court upheld the statute because the state was acting as a market participant.[90]

The Fourth Circuit found that under Dormant Commerce Clause analysis, state and local governments should not be treated differently for purposes of applying the market participant exception.[91] The court found that the correct inquiry was to determine when the state stops regulating its own market activities (including the activities of local government), as opposed to when the state begins regulating the activities of non-state interests, in which case the market participant exception no longer applies.[92]

The Fourth Circuit reasoned as follows:

> [W]e cannot discern a valid distinction to explain why state regulations that bind local governmental units should not be considered equally as innocuous, constitutionally speaking, as state regulations that bind statewide governmental units. Rather than focus on the state's action to see whether it is "regulatory," or on the quantitative impact of the regulation involved, the proper inquiry is onto whom the state regulates: so long as the regulated party is a public entity, we do not believe the market participant doctrine's bounds are exceeded.[93]

V. Which Approach Favored By the Various Federal Courts of Appeals Is Supported By Supreme Court Precedent?

The threshold question under market participant analysis when state government directs the proprietary actions of local government is whether the local government is considered by the courts as a proprietary entity separate from the state government or whether

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89. *See id.* at 1314.
90. *See id.* at 1319-20.
91. *See id.* The court stated:
> There is little analytic reason to treat the two separately for Commerce Clause purposes; market participation by either is immunized from negative Commerce Clause attack. State rules that "regulate" the market actions of a state's constituent agencies, departments and other state-level organizational manifestations are conceded not to be considered "market regulating" for negative Commerce Clause purposes. To posit then that the state is "regulating" the market in requiring local government to abide by its rules thus sidesteps the actual inquiry here, which is to determine at what point the state stops regulating itself and its action in the market qua market participant (a type of action immune from attack) and begins regulating non-state actors (a type of action subject to attack). *See id.*
92. *See Smith Setzer & Sons, Inc.*, 20 F.3d at 1319-20.
93. *Id.* at 1320.

local government is viewed as merely a subdivision of the state. This characterization is critical because a primary function of the "market participant exception" is to allow a state to regulate itself (meaning state agencies) in a manner that impacts a state's proprietary activities without running afoul of the Dormant Commerce Clause.[94]

State government provides local government entities with authority, thus allowing local government to act as an agent of the state in addressing the needs of the state's citizenry.[95] If the purpose of the market participant exception is to allow states to act in the market, even if such activity encumbers interstate commerce,[96] then the market participant exception would be most effective if it applied when the state is regulating local government.

Local governments perform a tremendous amount of purchasing, selling and hiring, which is a direct result of state government granting local government proprietary autonomy in the name of administrative efficiency.[97]

The decisions in this area of the Third, Fourth, Eighth and Ninth circuits differ in a fundamental nature from that of the Seventh Circuit. Those courts, unlike the Seventh Circuit, did not look to which entity (the state or local government) was in fact doing the purchasing, looking instead to whether the local entity was merely an extension of the state.[98] The most recent of this line of cases, *National Solid Waste Management Association,* articulated this characterization as follows:

> In this case, the state is performing as a market participant in directing the behavior of local government units. Under Minnesota state law, the legislature has unlimited authority over local government units. All of the public entities covered by [the regulation in question] derive their power solely from the state. We are hard pressed to fathom how an entity created by the state, controlled by the state, and subject to the absolute power of the state, should be considered an independent entity

94. *See id.* at 1319 (The court stated: "State rules that 'regulate' the market actions of a state's constituent agencies, departments, and other state-level organizational manifestations are conceded not to be considered 'market regulating' for negative Commerce Clause purposes.").

95. *See Trojan Tech., Inc.,* 916 F.2d at 911 n.15.

96. *See Independent Charities of Am., Inc.,* 82 F.3d at 795.

97. *See Big Country Foods, Inc.,* 952 F.2d at 1179.

98. *Compare National Solid Waste Mgmt. Ass'n.,* 146 F.3d at 597, *and Smith Setzer & Sons, Inc.,* 20 F.3d at 1319-20, *and Big Country Foods, Inc.,* 952 F.2d at 1179, *and Trojan Tech., Inc.,* 916 F.2d at 911, *with W.C.M. Window Co., Inc.,* 730 F.2d at 495.

> when it undertakes to buy waste services on the open market.(citations omitted)[99]

Thus, under the analysis adopted by the Third, Fourth, Eighth and Ninth Circuits, who was in fact making the purchases is irrelevant as to who is actually the market participant.[100]

A. The United States Supreme Court's Application of the Market Participant Exception to Local Governmeny

The Supreme Court has, in decisions dealing with the relationship between state government and local government entities, held that local government units are merely an extension of the state.[101] The Court has stated that "however great or small its sphere of action, it [the local government entity] remains the creature of the state exercising and holding powers and privileges subject to the sovereign will."[102]

Yet, the Unites States Supreme Court does not treat local government as being equivalent to state government for all constitutional inquiries. For example, Eleventh Amendment immunity does not bar suit against municipalities.[103] However, in *White v. Massachusetts Council of Construction Employers, Incorporated,* the U.S. Supreme Court ruled that the proprietary actions of local government fall within the market participant exception to the Dormant Commerce Clause.[104]

White dealt with the constitutionality of an executive order issued by the mayor of Boston which required that all construction projects funded all or in part by the city had to be performed by a work force consisting of at least fifty-percent bona fide residents of Boston.[105] The United States Supreme Court held that the

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99. *National Solid Waste Mgmt. Ass'n.*, Inc., 146 F.3d at 599-600.

100. *See id.* at 599; *Smith Setzer & Sons*, Inc, 20 F.3d at 1319; *Big Country Foods, Inc.*, 952 F.2d at 1179; *Trojan Tech.*, Inc., 916 F.2d at 911.

101. United Building & Constr. *Trade Council of Camden County and Vicinity v. Mayor and Council of the City of Camden*, 465 U.S. 208, 215 (1984) ("a municipality is merely a political subdivision of the state from which its authority derives").

102. *Trenton v. New Jersey*, 262 U.S. 182, 187 (1923).

103. *See Lincoln County v. Luning*, 153 U.S. 529, 530 (1890) ("[T]he Eleventh Amendment, which restrains the jurisdiction granted by the Constitution over suits against State, is of necessity limited to those suits in which the State is a party of record.").

104. See *White*, 460 U.S. at 204.

105. *See id.* at 205.

executive order was constitutional under the market participant exception.[106]

The court found that the singular inquiry as to the applicability of the market participant exception is whether the constitutionally challenged action "constituted direct participation in the market" by the state or local government entity.[107] The court found that those hired to work on city funded projects were, in essence, employees of the city of Boston.[108] Therefore, the city was acting as a market participant by choosing whom it would hire.[109]

Under the holding of *White*, the proprietary activities of local government entities are eligible to fall within the market participant exception to the Dormant Commerce Clause.[110] However, *White* dealt with a local government generating a restriction on its own proprietary activity.[111] The case did not deal with a situation where the state was directing the purchasing of a local government entity, as was the case in *W.C.M. Window* and *National Soild Waste Management Association.*[112]

The Seventh Circuit, in *W.C.M. Window*, distinguished the situation at issue in that case from the Supreme Court's holding in *White*.[113] The Seventh Circuit found that the Illinois preference law was not limited to projects funded or administered in full or even in part by the state of Illinois.[114] The Seventh Circuit therefore found that the validity of the Illinois preference law was not dictated by the holding of *White*, as the order in question in *White* only dealt with projects funded by the city of Boston.[115]

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106. *See id.* at 208 ("when a state or local government enters the market as a participant it is not subject to the restraints of the Commerce Clause.").

107. *Id.*

108. *See id.* at 211 n.7.

109. *See White*, 460 U.S. at 211 n.7.

110. *See id.* at 208 ("when a state or local government enters the market as a participant it is not subject to the restraints of the Commerce Clause.").

111. *See id.* at 205-206 (the mayor of Boston issued the executive order requiring the hiring of Boston residents).

112. *See W.C.M. Window Co., Inc.*, 730 F.2d at 493; *National Solid Waste Mgmt. Ass'n*, 146 F.3d at 597-98.

113. *See W.C.M. Window Co., Inc.*, 730 F.2d at 495.

114. *See id.*

115. *Compare id., with White*, 460 U.S. at 205. The Seventh Circuit distinguished the situation in *W.C.M. Window, Inc.* from that in *White* as follows:

> . . .if the State of Illinois had limited the preference law to construction projects financed (in whole or in part) or administered by state, it would be clear after *White* that the law did not violate the commerce clause. But the state has gone further. The preference law applies to every public construction contract in Illinois, even if the purchaser is a local school board, or for that matter the local dogcatcher.

See W.C.M. Window Co., Inc., 730 F.2d at 495.

The Seventh Circuit held that due to the lack of state financial or administrative involvement in the projects covered by the Illinois preference law, the market participant exception did not apply.[116] The court found that the state was in fact acting as a regulator, "telling thousands of local government units that they must not give construction contracts to employers of nonresidents."[117]

However, under Supreme Court precedent, the correct inquiry to determine whether local government proprietary action taken in response to state regulation can fall within the market participant exception is to determine whether the local government agency is ultimately independent from the state.[118]

B. *State Government and Local Government as a Unified Market Participant*

White stands for the proposition that local government proprietary action is included in the market participant exception.[119] When this holding is analyzed in light of Supreme Court rulings that local government entities are creatures of the state, deriving their power and authority from the state,[120] it seems clear that the analysis of the Third, Fourth, Eighth and Ninth Circuits has greater justification in Supreme Court precedent than does that of the Seventh Circuit's decision in *W.C.M. Window*.

State law provides further insight into the relationship between local and state government. In Minnesota, the state dealt with in *National Solid Waste Management Association*, courts have held as a matter of state law that the state legislature has complete

116. *See W.C.M. Window Co., Inc.*, 730 F.2d at 495.

117. *Id.* The Seventh Circuit then went on to determine that the regulation was unconstitutional under the Dormant Commerce Clause as the state was unable to provide a legitimate local interest to justify the regulation. *See id.* at 496.

118. *See White*, 460 U.S. at 208. The *White* court stated that whether the activities of state or local government fall within the market participant exception depends upon "a single inquiry: whether the challenged program constituted direct state participation in the market." *Id.* Therefore, if state and local government are seen as one in the same when the state directs the proprietary activities of local government, the exception should apply. *See id.* The Seventh Circuit suggests that which entity is in fact making or paying for the purchases in question should determine the applicability of the exception. *See W.C.M. Window Co., Inc.*, 730 F.2d at 495. This analysis seems flawed in light of *White* because if the local government is viewed as part of the state, then the state is directing its own proprietary activities in regulating the purchasing, selling or hiring of local government. *See White*, 460 U.S. at 208.

119. *See White*, 460 U.S. at 208.

120. *See United Building*, 465 U.S. at 215; *Trenton v. New Jersey*, 262 U.S. at 187.

authority over local government entities.[121] In Pennsylvania, the courts have stated: "[a] county is merely a subdivision of the State Government. It is neither a sovereign nor an independent entity."[122] The Pennsylvania Supreme Court has held that the state has absolute control over local government entities, and that the state has the ability to add or subtract from the local entities' authority.[123] The Pennsylvania court's analysis of the relationship between the state and local government was applied by the Third Circuit *in Trojan Technologies*.[124]

In *W.C.M. Window*, the Seventh Circuit noted that for many purposes, including Due Process and Equal Protection analysis, every local government entity in Illinois is part of the central state government.[125] The court, however, declined to apply this general rule to cases dealing with Dormant Commerce Clause challenges.[126] The court instead chose to pronounce a rule requiring case by case inquiries into the degree of autonomy held by the local government unit to determine whether it should be consider as part of the state government.[127]

The problematic nature of the Seventh Circuit's approach is illustrated by the Supreme Court's statement in *Reeves* that one of the central reasons for the existence of the market participant exception is the inherent difficulty in analyzing the nature of state proprietary functions.[128] Therefore, a case by case analysis as to which entity, the state or the local government, is actually the market participant and to what extent the local entity is autonomous from the state is contrary to the very reason the

121. *See Erickson v. Gram*, 210 N.W. 616, 616 (1926) ("The power of the legislature over municipal corporations is unlimited, save as to constitutional restrictions.").

122. *Department of Public Welfare v. Adams County*, 373 A.2d 143, 145 n.4 (Pa. Commw. Ct. 1977).

123. *See Pennsylvania Turnpike Commission Land Condemnation Case*, 32 A.2d 910, 913 (1943) ("The Commonwealth has absolute control over such agencies with power to add to or subtract from the duties to be performed by them or to abolish them.").

124. *See Trojan Tech., Inc.*, 916 F.2d at 911.

125. *See W.C.M. Window Co.*, Inc., 730 F.2d at 495.

126. *See id.*

127. *See id.*

128. *See Reeves*, Inc., 447 U.S. at 438 (the court stated that the market participant exception's inherent deference to the state is justified because activities and considerations involving state proprietary functions "will often be subtle, complex, politically charged and difficult to assess under traditional Commerce Clause analysis").

exception was created by the Supreme Court, that being ease of application.[129]

And while the Supreme Court has determined that state and local government are not to be treated as one in the same for purposes of Eleventh Amendment immunity, this is because the immunity conferred protects the state in its sovereign capacity.[130] However, the market participant exception, unlike the Eleventh Amendment, actually seizes on the "private" characteristics of state and local government when they act as parties to a commercial transaction.[131] The market participant exception recognizes that state and local government often conduct business in the market as if they were private actors.[132]

The "private" proprietary independence that local government enjoys from state government is a result of the intentional delegation of authority by the state.[133] If a purpose of the market participant exception is to allow the state to fulfill its obligation as trustee for its citizens by engaging in proprietary activities as if it were a private actor,[134] it seems unfounded that the exception would not apply because a state chooses to fulfill its obligations through more efficient localized means.

Finally, the Seventh Circuit's approach ignores another primary justification for the exception, that being that the state, when it enters the market, should be able to choose with whom it does business.[135] The Supreme Court's desire to allow a state to act in this manner would be minimized if the state could not direct the proprietary actions of local government, given the tremendous amount of proprietary activity local governments enter into that effect a state's citizenry.

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129. *See id.*

130. *See Lincoln County*, 153 U.S. at 530.

131. See *Reeves, Inc.*, 447 U.S. at 439.

132. See *id.* (the Supreme Court stated that "the commerce clause was directed, as an historical matter, only at regulatory and taxing actions taken by the states in their sovereign capacity"). Thus, the reason the market participant exception acts to allow the state to permissibly burden interstate commerce without running afoul of the Dormant Commerce Clause is that the state, when participating in the market, is acting in a quasi-private manner, rather than strictly in its sovereign capacity. See *id.* ("When a State buys or sells, it has the attributes of both a political entity and a private person.").

133. *See Big Country Foods, Inc.*, 952 F.2d at 1179 (stating that local government control fosters administrative efficiency).

134. *See Reeves*, Inc., 447 U.S. at 438 (stating that the market participant exception allows the state to perform its role as trustee for its citizens free of Dormant Commerce Clause restraints).

135. *See id.* at 438.

VI. Conclusion

The analysis of whether the market participant exception to the Dormant Commerce Clause should apply when state government is directing the proprietary action of local government hinges on whether the state is seen as a market regulator or as a market participant. The approach taken by the Third, Fourth, Eight and Ninth Circuits characterizes the local government entity as merely a subdivision of the state.[136] Thus when the state directs local government, the state is in essence directing its own proprietary activities and the market participant exception applies.[137] The Seventh Circuit, however, has found that if the local entity itself is engaging in proprietary activities without direct funding or administration from the state, then the local entity is a market participant independent from the state and the state is acting in a regulatory fashion.[138]

The favorable approach, in light of Supreme Court precedent, is that taken by the Third, Fourth, Eighth and Ninth Circuits. The U.S. Supreme Court has stated that local government entities are merely extensions of the state, a characterization that is also present under state law. Therefore, if local government exists at the will of the state, deriving authority from the state, then the state can constitutionally direct the purchasing choices of its local branches under the market participant exception.

The approach taken by the Seventh Circuit ignores that local governments are dependent on the state for their proprietary authority and requires that courts make a case by case analysis into the autonomy of local government. Such an approach fails to consider two fundamental reasons for the creation of the market participant exception. The first being ease of application in dealing with state proprietary activity, and the second being the right of the state to act for the benefit of its citizens in selecting whom it chooses to do business with, be it at the state or local level.

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136. *See National Solid Waste Mgmt. Ass'n.*, 146 F.3d at 597; *Smith Setzer & Sons, Inc.*, 20 F.3d at 1319-20; *Big Country Foods, Inc.*, 952 F.2d at 1179; *Trojan Tech., Inc.*, 916 F.2d at 911.

137. *See id.*

138. *See W.C.M. Window Co., Inc.*, 730 F.2d at 494.

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